

Widening Opportunities for South-North Economic Cooperation

Center for Reunification Economics

1. Recent Changes in South-North Relations and Economic Cooperation

After the historic North-South Summit held in June, inter-Korean relations have been progressing at a breathtaking pace. Ministerial meetings will be held regularly between the two Korea's to execute the clauses of the June 15 Joint Announcement. Meetings will also occur between special envoys, defense ministers, participants in economic cooperation, and Red Cross organizations. In addition, both sides are actively tackling issues such as reuniting of separated families, reconnecting the Seoul-Shinuiju Railway, return of diehard political prisoners to North Korea, planning of tours of Mt. Halla and Mt. Paekdu, and the shipment of 500,000 tons of food support to the North.

In October, a group of North Korean economic inspectors will visit the South, and in early 2001, North Korean Leader Kim Jong Il is scheduled to make a visit to Seoul, preceded by North Korea's ceremonial head of state Kim Yong Nam. In addition, cultural exchanges have been pursued, including the visit to North Korea by South Korean press presidents, and the Seoul visit of North Korea's National Symphony Orchestra. Corporate investment in the North has also been active, with Hyundai pursuing investment in North Korea's Kaesong Economic Zone following its Mt. Kumgang Tour project.

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Era of reconciliation and cooperation

As the above events illustrate, North-South relations are improving on a scale unprecedented since the Korean War. An atmosphere of reconciliation and cooperation as well as peaceful coexistence is spreading throughout the peninsula. The new atmosphere that has formed after the June Summit can be seen in several respects.

First, the tensions among the two Koreas have eased dramatically. Both sides have halted their slander campaigns against each other, and for the first time since the division of the peninsula the North Korean defense minister visited the South to meet his Southern counterpart. Besides their practical implications, the symbolic significance of these developments is great, and one can see that the June Summit was a turning-point to a new era in inter-Korean relations.

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Exchange and cooperation has been another area to improve after the June Summit. Working-level meetings on economic cooperation have taken place to create institutional mechanisms such as investment guarantees, prevention of double taxation, and settlement of accounts. Work to reconnect the Seoul-Shinuiju Railway - a future transport link to the Eurasian continent - has begun, as well as highway

connection between Munsan in the South and Kaesong in the North. Furthermore, the Hyundai Group's development of an industrial complex in Kaesong is expected to take economic cooperation to a new level. On completion, the complex is intended to occupy 20 million pyong of land, attract around 850 companies, create around 220,000 jobs per year, and raise an annual 20 billion dollars in export revenue.

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Tourism between the two Koreas is forecast to dramatically expand. In addition to the Mt. Kumgang tour that opened in late 1998, South Korean travellers will have the opportunity to visit the famed Mt. Baekdu as well as Kaesong. In Kaesong, visitors will be able to see a socialist area just starting to be transformed by capitalism. As the national capital during the Koryo dynasty, Kaesong is also a historical city containing many artifacts from that period.

North-South cooperation is also becoming apparent in the international arena. In the opening ceremonies of the Sydney Olympic Games, athletes of the two Koreas entered the stadium under one flag. At July's ASEAN regional security forum in Bangkok, the foreign ministers of North and South Korea met for the first time and agreed to cooperate in foreign relations and the international arena. Although it was cancelled because of an unforeseen event, a meeting at the UN Millennium Summit was also planned between Kim Yong-Nam, North Korea's second in command, and South Korean president Kim Dae-Jung.

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Coexistence on the peninsula: North Korea's relations with the US

North-South Korean relations have been moving in the direction of peaceful coexistence, which fits with world trends. However, there are some in the South Korean society who have worries about the progress of inter-Korean relations. One of the key topics of controversy is whether North Korea has really changed its basic position. In its meetings with the South, North Korea has mostly focused on acquiring economic aid, which some see as a sign that the North has only partially altered its position.

To preserve the regime, North Korea is trying to ease inter-Korean hostility and create an atmosphere of peaceful coexistence.

It is very unlikely that the North has either the will or the ability to invade the South, because North Korea's main priority at this time is regime preservation. The North's biggest fear is that the system will collapse and the country will be absorbed by the South. To preserve the regime, North Korea is trying to ease inter-Korean hostility and create an atmosphere of peaceful coexistence. Considering the North's goal, we can see why it has been somewhat hesitant to pursue issues -such as the reuniting of divided families- that could affect the country's security.

The peninsula's security configuration has also been a controversial topic. North Korea probably considers Seoul's alliance with Washington and the US troops stationed in the South to be the biggest threats to security. Therefore, the North will try to tackle security issues by focusing on as well as dealing directly with the US. For a peaceful resolution of the security issue, the relation between North Korea and the US is vital, and the issues of North Korean nuclear capacity or missiles should be

resolved diplomatically between the two countries. One thing for certain however, is that the recent progress in North-South relations has created a good atmosphere for a peaceful resolution of the security issues.

Some also worry that the South is being too passive and is compromising too much to the North in the recent inter-Korean developments. Indeed, it does seem that the new developments are being led by the North. This is because the South Korean government was so focused on holding the inter-Korean summit and improving relations with the North that compromises became unavoidable to achieve these goals. In the defense ministers' summit for example, the ministers held no discussion on practical topics that would help reduce tension, such as a hotline between North and South military leaders, or joint communication regarding troop training or movement. The second Red Cross meeting was also a disappointment in that it proceeded according to the North's plan at the expense of the South's interests. Considering these problems, the worries about the South Korean government's North Korean initiative seem to be justified to some extent.

According to a recent survey by the Ministry of Unification, 59.8% of the South Korean public consider the progress in inter-Korean relations to be "on the fast side". The government should avoid hurrying the process, and rather than starting new projects, it should try to work on the agreements that have already been made. The government should also avoid giving the impression that it is in a hurry, and should try to be more effective in communicating its interests in future North-South meetings.

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The need for National Consensus

However, excessive worry about the current progress of North-South relations is undesirable. Although change in North Korea has not reached our expectations, it is impossible to go back once change has begun. Inter-Korean relations should be viewed from a long-term perspective, and is an issue for which the government should build a national consensus.

With the recent economic difficulties in the South, some are raising criticisms about the uni-directional flow of aid to the North. The government should carefully consider these criticisms, and pursue an aid program that the South Korean economy can handle. However, the government should not react to criticism by hiding facts from the public, as it did after the first economic working level meeting in October. Although it was agreed that the South send 500,000 tons of food aid to the North, this fact was not included in the press release for fear of public criticism, which raised a furor over the transparency of North-South meetings.

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While the government should base its North Korea policy on solid public approval, it should avoid policy that goes against world trends or exclusively caters to public opinion. In fact, the government should try to actively lead public opinion to fit with world trends of reconciliation and opening. When thinking about inter-Korean relations, the concept of two states should be replaced with the concept of Korea as one nation, and gradually, Koreans should think of a national community rather than considering security on the peninsula. In addition, because North-South relations are an important factor in Northeast Asian security, the two Koreas will need international approval in their efforts. Such domestic and international consensus will be a necessary foundation for improved North-South relations. **VIP**

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2. Significance of the Inter-Korean Railway Link

On September 18, ground-breaking ceremonies were held for the reconnecting of the Seoul-Shinuiju Railroad and highways between the North and South. This was a momentous occasion in Korean history, and occurred 15 years after the topic of reconnecting inter-Korean railways was mentioned at a North-South economic summit in 1985.

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The reconnection of the railway was a topic of intense interest since the landmark inter-Korean summit in June, and agreements on implementation were reached at the North-South Ministerial meetings held in July and August. If the project runs smoothly, the track will be finished by fall 2001, at a cost of about 150 billion won. According to the current plan, each side will be responsible for rebuilding the railway in their part of the peninsula. The South side plans to build a 12km section of the severed track between Munsan and Changdan, which will cost about 50 billion won. The North is expected to soon launch its own work of restoring another 15.6km-long stretch between Changdan and Kaesong, with construction costs at about 100 billion won.

Current railway status

At the moment only the Seoul-Shinuiju Railway has been selected for reconnection but it is possible that other lines will be restored in the future.

Seoul-Shinuiju

Although the 496.7km Seoul-Shinuiju line was originally a double-track railway, it has been reduced to a number of single-track sections.

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Running along the entire Korean peninsula, the Seoul-Shinuiju line may be able to connect with China's Beijing-Shenyang line in the future to give Korea access to the Asian continent.

Table 1. Sections of Seoul-Shinuiju Railway

Section	Susaek~ Munsan	Munsan~ Changdan	Changdan~ Bongdong	Bongdong~ Kaesong	Kaesong~ Pyongyang	Pyongyang~ Shinuiju	Total
Length (km)	37.8	11.8	7.8	7.8	187	225	477.2
Condition	single track	under repair	under repair	under repair	single track	single track	

Seoul-Wonsan

The Seoul-Wonsan line connects Seoul with the North Korean region of Hamkyong do. One possibility for this line is linkage with Russia's Trans-Siberia Railway via North Korea's Wonsan-Rajin line (Wonsan-Hungnam-Chongjin-Rajin).

President Kim Dae-Jung recently proposed the possibility of a railway link between Korea and Russia to Russian Prime Minister Putin. Because North Korea is also interested in economic benefits that will arise from such a project, there is a high possibility that the Seoul-Wonsan Line will be reconnected.

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Table 2. Sections of Seoul-Wonsan Railway

Section	Yongsan-Shintanri		Shintanri~ Pyongyang	Pyongyang~ Wonsan	Total
	Yongsan~ Uijongbu	Uijongbu~ Shintanri			
Length (km)	31.2	57.6	31.0	103.8	223.6
Condition	Double track	Single track	Under Repair	Single track	

Northern East-Sea Line

The 192.6km Northern East-Sea Line runs from Anbyun in North Korea to Yangyang in the South. Although it was closed after the Korean War, the North Korean section (from Anbyun to Ku'up-ri) was restored in the 1990's.

Mt. Kumkang Line

This line is a 116.6km electric line extending from Cholwon to the Kumgang area. It is currently closed.

After reconnection

The railway reconnections will bring important benefits to both North and South Korea. The restoration costs will be relatively low, while rail transport will outperform shipping in terms of cargo load, safety, and efficiency. North Korea may also prefer rail transport to the use of highways because it is easier to limit foreign interaction and citizens' travel for the former.

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There are a number of economic aspects to the railway reconnections. In a short term perspective, the North and South can pursue a win-win scenario. South Korea can dramatically cut both time and cost of its transport of goods to the North. Currently, the shipping cost for a 20-foot container from Incheon to Nampo is about

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1000 dollars, and it would take about two weeks to arrive. By rail, the cost would be around 200 dollars and the time would be cut to about 1 to 3 days. It is estimated that yearly transport costs can be cut by around 25 million dollars by using rail instead of marine transport.

The reconnection of the Seoul-Shinuiju line will promote further economic cooperation between the two Koreas and can become the basis for a economic interdependence on the peninsula. Currently, economic cooperation is limited to trade and basic contract manufacturing. After the connection of the Seoul-Shinuiju line and stimulated operation of the Kaesong economic zone, it is likely that economic activity will include more investment as well as heavier and more complex manufacturing.

North Korea will be able to gain a healthy amount of foreign currency from the Seoul-Shinuiju line by collecting tolls and rail usage fees. It is estimated that the North will be able to collect more than 100 million dollars from usage fees. Considering North Korea's current foreign exchange crisis, this development will be an immense benefit.

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In the long term, the railway can transform the Korean peninsula into the transport hub of Northeast Asia. Reconnection of the Seoul-Shinuiju line and the Seoul-Wonsan line will connect Korea to China, Mongolia, Russia, and even Europe. Transport will probably occur on a far greater scale after the Korean railways are integrated with their neighboring Trans-Siberia Railroad and Trans-China Railroads.

Another effect of the railway reconnection will be expanded economic and individual exchanges, which will help improve North-South relations. In the long term, railways will convey not only goods, but also individuals such as tourists and visitors. Increasing the number of such visits will help create a social basis for reunification.

Trust between the North and South military can also be improved through the railway restoration process, because it involves joint activities such as the removal of landmines.

Tasks for the future transport hub of Northeast Asia

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In the short term, repair of the North's aging railways is needed to maximize the benefits of railway reconnection. To make the inter-Korean railway an effective hub of transport in Northeast Asia, repair and facility improvements on North Korea's railroads are essential. For this, South Korea will have to lend its support. The North

Figure 1. Concept of Open and Integrated National Axes



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and South’s railways should also be standardized.

The two Koreas should closely cooperate with neighboring countries like China and Russia. Long term objectives should be set for a transportation cooperation in the region and the feasibility of projects should be analyzed in advance.

Of course, financing of the railway projects is a matter that cannot be ignored. While South Korea will shoulder most of the financial burden for reconnecting the inter-Korean railways, the costs of repairing the North Korean railway system may possibly be borne by a consortium of countries such as Japan, China, and Russia. Since repair of the North Korean railways would profit these neighboring countries through lower transport costs, they should explore various multilateral means of financing. **VIP**

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Table 3. Railway Repair Costs

Railway	Length	Estimated Repair Cost
Seoul-Shinuiju Line	500km	2 trillion won
Seoul-Wonsan Line	210km	840 billion won

3. Prospects for The Kaesong Industrial Area

After the inter-Korean Summit in June, North Korea started promoting economic cooperation with surprising speed. One of the most dramatic measures has been opening the Kaesong Industrial Area to South Korean investment. In the past, although both Koreas had agreed on the importance of an industrial area in the North, only South Korea actively pursued it, while the North stalled and hesitated. This was because North Korea thought the side-effects of opening could undermine its regime.

North Korea's opening of the Kaesong Area- reflects a change in the country's stance towards economic cooperation.

Therefore, North Korea's opening of the Kaesong Area - which is located near South Korea's capital of Seoul- reflects a change in the country's stance towards economic cooperation. With this move, North Korea hopes to pursue the two sometimes conflicting goals of preserving its regime and attracting hard currency.

This article examines Kaesong's investment environment and points out preconditions for the area's success. It also proposes a direction for the area's development.

Conditions for an Industrial Area

Industrial Conditions

Because of its proximity to South Korea, Kaesong is a good location for joint North-South industrial areas. The synergy effects are expected to be significant for both North and South Korea because of forward and backward industrial linkages.

The combination of South Korea's technology and capital with the North's skilled labor force is also expected to improve conditions.

In particular, if the Kaesong Industrial Area is connected with Seoul's investment community, Kaesong's investment conditions will improve dramatically in a short time. The combination of South Korea's technology and capital with the North's skilled labor force is also expected to improve conditions.

Infrastructure

The two Koreas have already agreed to reconnect rail and highway routes. When Munsan in the South is connected with Kaesong, transport efficiency to Seoul will improve greatly through reduced shipping costs and transit time. In addition, it will be easier for Southern companies to build infrastructure in Kaesong than in other areas in the North, because of Kaesong's proximity to the South.

Kaesong can also use the South's airports, Gimpo International Airport and the nearly-completed Incheon International Airport. South Korea's Incheon and Pyongtaek International Harbors can be used for marine transport.

Electricity is the most pressing infrastructure need for the Kaesong Industrial Area. Again, proximity to the South will be an advantage, because Kaesong may use the South's electricity, transported by electricity transmission towers. In the future, the area will probably be able to generate its own electricity.

For its water needs, Kaesong can use the nearby Imjin and Yesung Rivers as sources.

External Markets

The first market available to Kaesong is the nearby South Korean market. Entry conditions into this market are very favorable. By taking advantage of the North's cheap and skilled workers and the South's technology, Kaesong will be able to produce competitive goods, which can be transported to South Korea at a low cost.

In addition, if Kaesong cooperates with South Korean firms that have overseas sales networks, entry into foreign markets would also be possible. After transport networks are formed between the North and South, the peninsula will become a transport and industrial hub of Northeast Asia, and conditions for penetration into foreign markets will become even better.

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Living Conditions

The proximity to Seoul will improve living standards for those doing business in Kaesong. Kaesong is only about 80km, or a one hour drive from Seoul, so South Korean and foreign employees can commute to the area while living in Seoul. A similar case is Hong Kong and the Shenzhen Special Economic Zone.

Comparison with other Special Economic Areas

Preconditions for successful economic zones

There are several conditions for the success of a special economic area no matter where it may be located. First, it should have a cheap and skilled workforce; second, it should possess adequate infrastructure such as roads, railways, harbors and electricity; third, it should offer a wide range of tax benefits; fourth, it should guarantee the safety and freedom of investing firms; and finally, it should have a large domestic or export market.

Kaesong vs other economic zones

The economic zones of Vietnam and China are Kaesong's most likely competition for foreign investment. Because the Kaesong area has not begun operation, its conditions are relatively lacking compared to the economic zones of China or Vietnam.

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For example, while North Korea may have a slightly favorable tax environment, it is still weak in other conditions such as infrastructure, safety for business activity. Of particular importance, wages in North Korea are similar or higher than in China

and Vietnam, which is a problem that needs to be addressed for the Kaesong economic area to become established.

Table 1. Comparison of Economic Zones

Category	North Korea	China	Vietnam	Britain
Infrastructure	×			
Tax Exemption				
Management of Foreign Currency	×			
Labor Costs				×
Safe Business Climate	×			

Note: good, fair, × poor.

Kaesong Area 's Success

Offer more benefits than its competitors

In its opening to the rest of the world, North Korea is about 20 years behind China and 15 years behind Vietnam. To compete as a late-starter, it needs to provide far more benefits to investors.

Guarantee a cheap and skilled workforce

In the early stages of Kaesong's development, labor-intensive industries such as textiles, footwear and electronics assembly are expected to be the main focus. Therefore, the Kaesong area will run into difficulty if it cannot provide skilled workers for low wages. North Korea needs to propose a solution to this problem, and it should avoid having wages or bonuses paid indirectly through the state. Direct payment would raise worker productivity.

North Korea's decision to open Kaesong seems to have been reached after hard consideration. With the Kaesong project, the North is trying to attain two goals: maintaining its system and rebuilding its collapsed economy.

The fact that Kaesong is near Seoul is the area's greatest advantage. However, to increase the chance of success, both Koreas should try to follow the conditions mentioned above, as well as exploit the locational advantage as far as possible. The success of China's Shenzhen Special Economic Zone is based on its proximity to Hong Kong. In addition to providing a market for Shenzhen's goods, Hong Kong was the key supplier of capital and technology. Because they have similar conditions, Seoul and Kaesong should try to emulate the Hong Kong-Shenzhen model, and should be connected through communication, transport and trade. **VIP**

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